

INDUSTRY GROWTH PARTNERSHIPS:

ACHIEVING LEBANON'S TRUE ECONOMIC POTENTIAL

INDUSTRY CLUSTER DEVELOPMENT STRATEGIES

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Table of Contents

INTRODUCTION.....	1
I. LEBANON’S ECONOMIC NEEDS: A DIAGNOSTIC ASSESSMENT.....	3
A. Domestic Economic Performance.....	3
B. International Economic Performance	6
C. Lebanon’s Macroeconomic Policy Framework	7
D. Lebanon’s Commercial Policy Framework	8
E. Benchmarking Lebanon’s Commercial Policies Against Regional Countries	10
F. Unique Factors Affecting Lebanon’s Economic Strategy	11
G. An Economic Growth Initiative for Lebanon	13
II. THE POWER AND PROCESS OF INDUSTRY CLUSTER STRATEGIES	16
III. TOURISM INDUSTRY CLUSTER STRATEGY.....	20
IV. LIGHT INDUSTRY/AGRO-INDUSTRY CLUSTER STRATEGY	24
V. REGIONAL BUSINESS SERVICES CLUSTER STRATEGY	29
Appendix A: INDUSTRY CLUSTERS WORKSHOP PARTICIPANTS	33

INTRODUCTION

Lebanon's economy is poised to experience a period of accelerated and much needed growth in the years immediately ahead. This growth will be built upon the foundation of political stability and infrastructure reconstruction achieved over the past decade, and will be fueled by the nation's unique level of consensus favoring a pro-market, private sector-led development strategy. If undertaken correctly, the economic activities which collectively yield growth will provide direct benefits to all segments of Lebanese society, thereby creating a catalytic source of national unity and cohesiveness.

The outcome just described is clearly possible but is not assured. The building blocks for economic expansion are being put into place. The intricate task of establishing workable political processes and governmental systems is well under way. The enormously expensive undertaking of restoring and upgrading Lebanon's physical infrastructure is bearing fruit, but at a cost. It is now up to the nation's entrepreneurial private sector to assume responsibility for generating new and expanded productive enterprises needed to provide the jobs, income, foreign exchange and tax revenues that will feed growth and the improvement of standards of living.

If productive investments do not take place, then Lebanon's economic fortunes will be reversed. In this outcome, the inevitable course of events will be that the nation's massive buildup of government deficits and indebtedness will "take charge" and shape the country's economic processes and results. The financial and real estate market "bubbles" will burst, and regardless of whether the landing is "soft" or "hard," real incomes and living standards will decline, resulting in undesired social and political ramifications.

Every economy faces downside risk, and it is important to stress that Lebanon's economic balance sheet shows that the nation's assets far exceed its liabilities. Nevertheless, if the positive outcome is to be achieved, it is critically important for Lebanon's core productive industries to become organized and pursue productive investment opportunities much more aggressively than they have over the past few years. At the same time, the government needs to systematically remove policy-induced constraints and become a more effective partner with the private sector. Attaining that end is the goal of this initiative, as described in this report.

This report presents the findings and recommendations of a two-phased initiative designed to promote accelerated and sustainable economic growth in Lebanon. The initiative is being sponsored by the U.S. Agency for International Development Mission in Lebanon (USAID/Lebanon). The first phase consisted of a diagnostic assessment of Lebanon's economic conditions, constraints and opportunities, aimed primarily at identifying needs to be addressed during the second phase of the initiative. The second phase has been the preparation of industry "cluster" development plans for three sets of activities that offer strong growth potential in Lebanon: (1) tourism; (2) regional financial and business services; and (3) light industry and agro-industry. These cluster strategies have been prepared over the past few months by working groups with both private sector and public sector participation.

The overall project has been carried out by SRI International, in collaboration with Lebanese American University. SRI International, formerly known as Stanford Research Institute, is one of the largest non-profit research and consulting organizations in the United States, and is a leader in the field of economic development and industry cluster growth strategies. SRI and LAU would like to express our gratitude to the large number of government and private sector leaders who have contributed to this initiative by providing valuable insights and candid viewpoints on Lebanon's economic needs and prospects. We especially thank the industry cluster working group members, who have offered a substantial amount of time and effort to help their country by crafting imaginative programs to catalyze renewed growth in Lebanon.

Over the course of this project, our joint SRI/LAU team has encountered what we believe is an unprecedented level of interest and support. There is a unique consensus among both public and private leaders not only on the diagnosis of Lebanon's economic needs and opportunities, but also on the imperative for a set of concrete, growth-oriented initiatives. No one should underestimate the economic challenges facing Lebanon's economy. Nevertheless, this degree of consensus and good will bodes well for the comprehensive nation building that is now under way in Lebanon.

I. LEBANON'S ECONOMIC NEEDS: A DIAGNOSTIC ASSESSMENT

For many reasons it is important for Lebanon to “move on” from its war experience and turn its full attention to “invent” its future. Nevertheless, it is virtually impossible to assess needs and craft a growth strategy without referring to the war, since it so pervasively defines Lebanon's economic conditions and requirements.

A. Domestic Economic Performance

Lebanon's domestic economic performance is often perceived, whether appropriately or not, through the prism of Lebanon in 1974, which remains the reference point or benchmark from which Lebanese measure their economic status. There is a clear tendency for many to believe that the country's previous position as the most open and prosperous country in the region and the center for regional trade, finance, education, medicine, tourism and culture can be recaptured.

A more realistic approach, and one held especially by the younger generation of Lebanese professionals, is that while the economy took a “time out” for a protracted war lasting over 15 years, the rest of the world moved on, and so the conditions and lifestyles of 1974 cannot be restored. In any case, from an analytical standpoint it is appropriate to examine Lebanon's economic performance in three separate time frames: Pre-war Lebanon, the war years, and the post-war experience.

Pre-War Performance

Looking first at Lebanon's pre-war performance, despite occasional disturbances, the economy achieved solid economic growth and rising incomes over the period between 1950 and 1975. Yearly GDP growth in real terms averaged 6 percent, and inflation was held to an average of 3 percent annually. Per capita income was estimated in 1974 to be \$634, approaching that of Portugal and about three times the levels prevailing in Egypt or Jordan.

In the mid-1970s, Lebanon was considered a middle-income country. The exchange rate was relatively stable. Net capital inflows and invisibles earnings covered the chronic trade deficit, contributing to ample foreign currency reserves at the Central Bank. Government revenues in that period equaled 20 percent of the GDP, but expenditures were only 15 percent, generating budget surpluses.

Lebanon's enviable record resulted from a combination of geography, culture and history. In a world not yet linked globally in terms of communications and technology, Lebanon was geographically well situated to serve as an intermediary between Europe and the Near East, as well as to act as a business and financial center for the regional market. The nation's cultural diversity, social tolerance and dedication to private enterprise and an open economy made Lebanon attractive to Europeans and regional nationalities, and provided the milieu in which the Lebanese could develop their own skills.

The Impact of War

Lebanon's internal war was episodic but long lasting. It wreaked great physical damage, virtually marginalized the central government and seriously weakened the country's economic and social institutions. Individual Lebanese who lived through this turmoil were forced to place their highest priority on assuring personal safety and securing their economic survival.

The nation's tourism, financial and trading activities, the pillars of the economy, all but disappeared. A host of factories, both large and small, were bombed repeatedly. Land mines were set in both rural and urban areas. Many entrepreneurs and their families fled the country in order to gain personal security. Retail establishments closed their doors. Levels of per capita income and standards of living fell precipitously. In short, the nation was devastated by a continuous downward economic spiral that led eventually to little more than subsistence activities.

Recent Economic Developments

The initial transition from war to peace was tumultuous in economic terms. In 1990, Lebanon's GDP is estimated to have shrunk by around 14 percent. However, in 1991 the economy bounced back strongly, with growth estimated at 38 percent. In 1992, inflation on the order of 120 percent triggered a flight from the pound and the exchange rate in September of that year reached L£2,830 to the dollar. Net GDP growth nevertheless was estimated at 4.5 percent in 1992.

Over the past few years, economic activities have been closely associated with Lebanon's reconstruction efforts. Much has been accomplished in terms of restoring Lebanon's physical infrastructure. The telecommunications system has largely been rebuilt, and the new airport is in operation. Electric power has been restored to a level where most of the country has 24-hour a day power. Much of the water supply system now functions and major construction projects are under way for roads, the port of Beirut and public buildings. Private construction has also been active in restoring or building hotels, offices, shops and apartments.

The structure of Lebanon's economy has changed relatively little from pre-war to post-war times. During the war, trading and other services were handicapped, giving agriculture a proportionate boost. At present, however, agriculture is of even less importance than previously thought. The share of industrial output has returned to that in pre-war years, and tourism and other services are again becoming an important element in the economy. The rebuilding process, together with increased income, has greatly expanded Lebanon's merchandise imports. This means that Lebanon can maintain current consumption and savings levels only through substantial net inflows of services income, capital, and remittances.

Both domestic and foreign direct investment has been more limited than expected. Most investment has been directed toward real estate and portfolio investments. Investment in productive activities has been made, especially in selected areas such as construction materials and banking, but this trend has witnessed serious deterioration. Factors inhibiting productive investment include:

- ✓ Perceived political risks, mostly external, but some internal.
- ✓ Apprehension over the direction of Lebanon's economy and concern over the sustainability of the government's macroeconomic strategy.
- ✓ The small size of the local market.
- ✓ High local costs for labor, real estate, transportation, etc., along with the belief that the Lebanese pound is overvalued, which detracts from price competitiveness in regional/world markets.
- ✓ The availability of attractive investment alternatives, including Treasury securities, fixed deposits, and carefully selected real estate investments.

A number of policy-induced disincentives also constrain investment in productive activities. These include but are not limited to the following:

- ✓ Lebanon lacks effective protection for intellectual property rights, creating a disincentive for high technology and media investments.
- ✓ There is no formal competition policy, which adds to the perception that Lebanon's economy is controlled by a small number of business groups.
- ✓ There are serious concerns regarding Lebanon's labor policy, especially the issue of social security administration, costs and services.
- ✓ The tariff structure impedes industrial activity and distorts agricultural trade but is difficult to change since it is a major source - approximately 45 percent - of government revenue.
- ✓ Finally, dealing with Lebanese government bureaucracy is not always an easy or expeditious process.

Investors can accept – and discount for – political risk and structural inefficiencies when the economic returns are sufficiently high. Alternatively, if the prospective economic returns are modest, then the policy and overall operating climate must be very attractive. Currently, the structure of disincentives and incentives tilts in favor of nonproductive rather than productive investments.

The world has changed during the period that Lebanon effectively receded from the international economic scene. The tremendous growth of oil revenues in Saudi Arabia and the Gulf has come and gone. Dubai, Bahrain and Kuwait have emerged as financial/entrepôt centers. The economies of Egypt and Turkey have expanded greatly, and Jordan has changed from a sparsely populated state to a modern economy in terms of business, finance and trade. The expansion of the European Union, the emergence of East and Southeast Asian economies, and more recently the collapse of the Soviet Union and eastern bloc all have made the world of the 1990s a vastly different place.

Over this period, Lebanon did not participate in many rounds of growth, modernization and competitiveness enhancement. In fact, in many respects Lebanon's operating environment deteriorated. The tendency for the government to intervene in the economy, begun out of necessity during the war years to solve pressing social or economic problems, has led to distortions in the economy which are largely unacknowledged. In addition, many segments of the private sector have not made the investments needed to restore international competitiveness.

In sum, Lebanon has made remarkable progress in the 1990s, but growth has now leveled off considerably. This in turn gives rise to the need for concerted efforts to restore the nation's economic momentum.

B. International Economic Performance

Lebanon historically has been a service economy, importing more goods than it exports, and covering its trade deficit with surpluses in its services and capital accounts. The country has run overall balance of payments deficits only twice in the past twenty years. But now under the pressure of heavy expenditures for reconstruction and the general rebuilding of the economy, the merchandise trade deficit has grown to tremendous proportions for a small economy like Lebanon.

A major issue confronting Lebanon is its need to maintain balance in its overall payments accounts despite the deficit in merchandise trade. Only through preserving adequate foreign exchange reserves can Lebanon maintain the exchange value of its currency, and hence sustain sufficient confidence on the part of foreign investors to buy Lebanese public and private debt instruments. The trade deficit is covered by several factors -- some exports and re-exports (including unreported transactions), invisibles income from services such as tourism, remittances from overseas Lebanese, and capital inflows.

C. Lebanon's Macroeconomic Policy Framework

Lebanon's senior economic management team is sophisticated according to both regional and international standards, and strongly supports appropriate policy principles. Policy makers embrace the desirability of private sector-led growth, and voice a common view against government intervention in the economy. These leaders are supported by a widespread national consensus in favor of market forces and private enterprise. Notwithstanding disagreements in other areas, the degree of unanimity on long-term economic policy is unique, and represents a strength upon which Lebanon can build an effective, unifying strategy.

The nation's fundamental dilemma regarding macroeconomic policy stems from the need to rebuild the economy and at the same time maintain socio-political stability, which implies high government expenditures, despite the fact that Lebanon's productive sectors are not yet ready to finance the fiscal burden through tax revenues.

The government to date has been able to finance its deficits through the issuance of Treasury securities denominated in local currency in maturities ranging between 91 days and two years. Seventy percent of these securities are held by Lebanese commercial banks, and only 20 percent by individual investors. Returns on public debt instruments have reached as high as 28 percent, but now range between 14 and 18 percent depending on the length of maturity. For the banks, these have offered an opportunity to earn attractive returns on capital in the face of weak domestic demand for loan credit.

The Lebanese government kept to its reconstruction plan with little deviation until late in 1997, when it acknowledged that some modification might be in order. The government's budgets postulate substantial shortfalls between revenues and expenditures, leading to increasing public debt and an increasing debt service burden. Aggravating the situation is the fact that government deficits have consistently exceeded the stated budget targets. To finance these deficits, the government's macroeconomic policy strategy has been to maintain control over the money supply both to reduce inflation and to provide interest rates high enough to make treasury securities attractive to investors.

There is a growing consensus in Lebanon that continued large government deficits are unsustainable. Interest payments on the public debt now amount to about one half of the Government's proposed budgeted expenditures. Net public debt is now equal to the whole estimated annual GDP of Lebanon.

The danger is that if uncorrected, Lebanon's ability to attract increasing amounts of foreign capital inflows may prove inadequate to cover the deficit, leading to a crisis of confidence, capital flight, and a difficult "hard landing" for the economy. Proposed solutions focus on both increasing revenues and reducing expenditures. Increasing revenues implies either new taxes or higher tax rates. On the expenditure side, there are questions as to the efficiency of current government spending in terms of value received for money spent. On the other hand, the government has been faced with complaints about the lack of spending for social programs such as education, community rebuilding and agricultural improvement.

It is clear that in the near term, Lebanon will not “grow” itself out of its public sector deficits or cover its public debt. This suggests that the burden of adjustment will rest on new fiscal measures. Ultimately, however, the only viable solution to the nation’s macroeconomic dilemma is growth in productive economic activities. By creating new income and employment, these not only will generate increases in government revenues, but also will reduce pressures for the government to provide employment and social services.

D. Lebanon’s Commercial Policy Framework

As in most parts of the world, Lebanon’s policy-makers have recognized the need for a sound commercial and economic policy environment which maximizes competitiveness, efficiency, and the creation of productive employment. After several years of concerted efforts to re-establish a competitive commercial environment, it is useful to stand back from the process to evaluate the strengths and remaining weaknesses in Lebanon’s commercial policies.

Given the importance of a business-friendly commercial policy environment for private sector development, it is imperative for policymakers to identify feasible policy alternatives, and to assess their effectiveness. To this end, cross-country experiences can be utilized to examine specific policy approaches and the lessons learned from their successes and failures in enhancing economic performance. Cross-country data is also useful for conducting policy benchmarking, which is an effective technique for assessing the comparative position of a country's commercial policy regime against its competitors in attracting international investment and trade.

This section presents the findings of an analysis conducted by SRI to identify those policy practices which are conducive to private sector development and sustained economic growth. The methodology is designed to allow cross-country comparisons of overall commercial policy regimes through summary country policy scores, which describe the degree to which commercial policies are business-friendly as well as competition-based.

The policy variables analyzed are classified under nine categories:

- | | |
|-----------------------------|-------------------------------|
| 1. Business start-up | 6. Domestic investment |
| 2. Pricing\interest | 7. Foreign investment |
| 3. Import | 8. Labor |
| 4. Export | 9. Taxation |
| 5. Foreign exchange | |

The policy variables were categorized so that they could be assessed as policy groups in forming the overall commercial policy environment. Such classification can also accommodate cross-country comparison in each individual policy category. SRI designed a rating system which assigns summary policy scores to each nation.

POLICY VARIABLES INCLUDED IN THE DATA SET

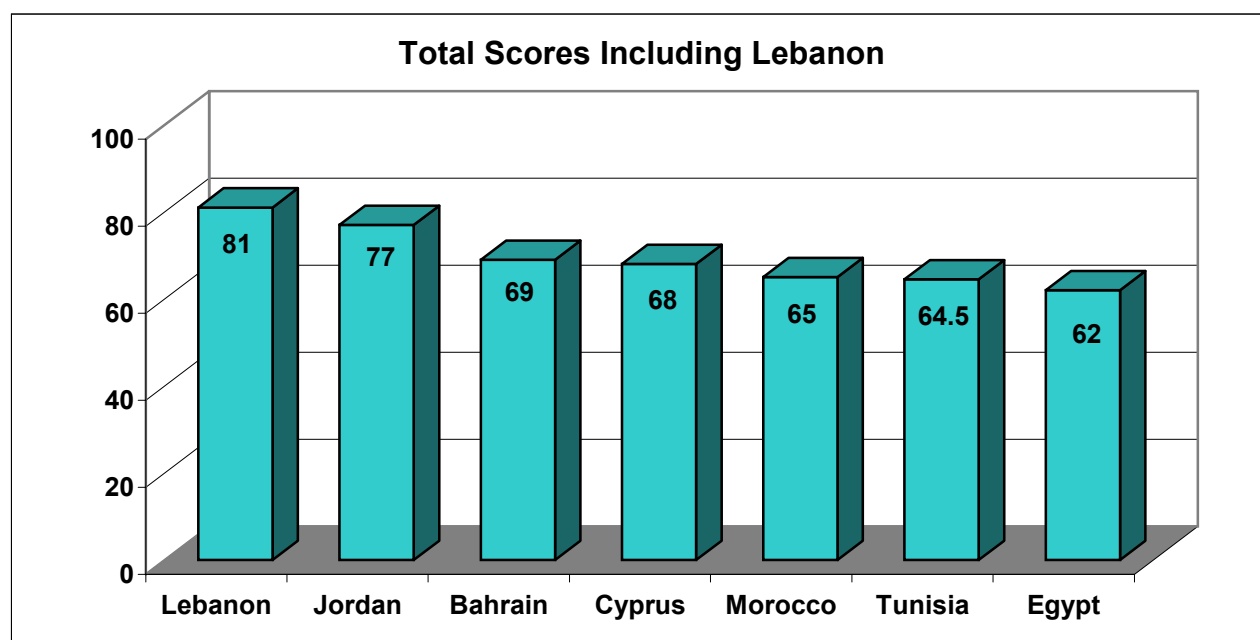
<u>Policy Category</u>	<u>Policy Variable</u>
Import	Mean Trade-Weighted Tariff Tariff Variance All Non-Tariff Barriers
Export	Export Taxes Export Restrictions Export Income Tax Exemptions Duty Free Imports
Tax	Minimum Corporate Income Tax Rates Top Corporate Income Tax Rates Minimum Personal Income Tax Rates Sales Taxes + Value-Added Tax Rates
Domestic Investment	Income Tax Holidays Duty Exemptions Other Incentives: Accelerated Depreciation Investment Allowance R&D Incentives
Foreign Investment	Direct Investment Restrictions Expatriate Employment Restrictions Differential Treatment Between Domestic and Foreign Investment Dispute Settlement Mechanisms
Business Start-Up	Business Licensing Business Registration Approvals
Pricing & Interest	Price Controls Price System Interest Controls Credit Allocation
Foreign Exchange	Exchange Rate System Foreign Exchange Level Foreign Exchange Restrictions Profit Repatriation Restrictions Capital Repatriation Restrictions
Labor	Hiring/Firing Flexibility Minimum Wage Wage Controls

Under this system, both quantitative and qualitative information is converted into a set of policy scores. The scores of the policy variables within the same policy category are then summed and harmonized. The Total Score (TS) for each country is obtained by summing the weighted scores from all the policy categories. The maximum achievable Total Score for a country is 100. Total Scores can be compared across countries as a summary description of the commercial policy environment. In addition, comparisons and benchmarking can be conducted in each policy category by comparing the Policy Category Scores across all countries or groups of countries.

E. Benchmarking Lebanon's Commercial Policies Against Regional Countries

This section compares Lebanon's commercial policy scores with those of other countries in the Middle/Near East. The countries were chosen as competitors or models against which Lebanon can be benchmarked in terms of "policy competitiveness."

The following countries were chosen as regional benchmarks: Bahrain, Cyprus, Egypt, Jordan, Morocco and Tunisia. The countries in this group have commercial policy scores ranging from 62 to 81 points. As one can see from the following chart, Lebanon leads the group



with a very strong overall scores of 81. With the exception of Jordan, Lebanon's scores are significantly higher than those of other nations in the region. Lebanon scores nineteen points higher than Egypt. Egypt (62 points), Tunisia (64.5 points), and Morocco (65 points) have the lowest scores among those selected for comparison. These scores place most of these countries in the middle of SRI's worldwide ranking of commercial policy scores.

Scores in the specific policy categories indicate that some commercial policies are consistent across the region while others vary greatly (see table below). Most countries have

similar scores for export and pricing policies. However, other policy categories display a significant divergence in scores. For example, country scores for import, taxation and labor policies vary substantially. Lebanon compares extremely favorably to its neighbors in most categories. It has one of the highest scores in five out of the nine categories: Import, export, taxation, pricing and labor policies.

REGIONAL COMMERCIAL POLICY SCORES

Country	Imports	Exports	Tax	Invest- ment	Foreign Direct Inv.	Business Start-up	Pricing/ Interest Rates	Foreign Exchange	Labor	Total
Lebanon	12	8	16	4	4	4	9	16	8	81
Jordan	12	6	16	8	6	4	9	8	8	77
Bahrain	8	6	16	4	6	6	9	8	6	69
Cyprus	8	8	12	4	8	6	6	12	4	68
Morocco	8	8	4	6	8	6	9	12	4	65
Tunisia	4	8	8	6	6	8	7.5	12	5	64.5
Egypt	8	6	4	6	5	4	9	16	4	62
Average	8.6	7.1	10.9	5.4	6.1	5.4	8.4	12.0	5.6	69.5

F. Unique Factors Affecting Lebanon's Economic Strategy

Any strategy designed to stimulate a nation's productive economic activities should be based on the country's actual conditions, opportunities and constraints. Each nation is unique and faces a singular blend of economic, social and political factors that collectively determine its economic prospects. Accordingly, each requires its own tailored approach to fit its particular circumstances. Lebanon displays a number of special factors or "drivers" that represent conditions that need to be taken into consideration in the design and implementation of an effective economic strategy. These include both constraints that need to be addressed and opportunities upon which a plan should capitalize.

Constraint Drivers

Externally-imposed political risk. Perhaps more than any other nation in the region, Lebanon is subject to outside political and military forces that are beyond its control, materially affect internal political stability, and considerably raise the level of uncertainty and risk facing investors.

The cost of physical reconstruction. Fifteen years of war, much of it conducted in urban settings, devastated Lebanon's infrastructure and capital stock of buildings and physical facilities. The cost of restoration is enormous, and is the key factor driving the nation's macroeconomic policies and performance.

The need to modernize “soft” infrastructure. Lebanon’s prolonged war left a need that is less visible but no less urgent than reconstructing the nation’s physical infrastructure. This is the requirement to install modern “soft” infrastructure -- the institutions, processes and administrative systems which collectively support productive economic activities, by upgrading the quality and availability of effective “systems” such as tax and tariff administration, technical training, computerization and advanced information technologies, and efficient organizational management structures. This is true for both government agencies and private sector firms, neither of which was able to invest in initiatives to improve quality and competitiveness.

The small size of the market. With a population of less than four million and per capita incomes below those prevailing in pre-war years, Lebanon is not a large market by international standards. As a result, the local market alone is not sufficient to provide the economies of scale necessary to support competitive, productive activities in certain areas, especially manufacturing requiring high volume throughput.

Lack of consensus on Lebanon’s economic future. There is no easily discernible common view or “vision” on where the economy will be in the future, or more importantly on what should be the appropriate direction for the Lebanese economy in the future. While this is not necessarily unique among nations, countries (and regions within countries) which have implemented successful economic development strategies have usually established a strong degree of consensus on where their economies will go and/or where they should move toward over time.

Opportunity Drivers

The pro-market orientation of the government and people. Unlike many other countries in the region, Lebanon’s economic prospects are heightened by the strong belief in private sector-led growth held not only by the government, but also by all segments of society. This outlook precludes the need to reform a wide battery of interventionist government policies, and in addition provides constituencies and support for the removal of remaining policy obstacles.

The heritage of entrepreneurship. The Lebanese are unique within the region for the degree of entrepreneurship they display. In fact, they are known throughout the world as business minded individuals. This characteristic can serve as a strong asset for both domestic and regional economic ventures.

The Lebanese “Diaspora.” For decades if not centuries, Lebanese individuals and families have moved to other locations throughout the world for both economic and political reasons. In their new countries, like other hard-working groups, they have established thriving businesses and accumulated income and wealth. At the same time, the overseas Lebanese have for the most part retained strong ties to their family members in Lebanon and to the home country itself. Thus the overseas Lebanese constitute a major economic asset, both currently and prospectively. Inward remittances support family incomes and the nation’s balance of payments, and as one looks to the future, the global network of enterprises operated by Lebanese provides a valuable foundation on which new productive activities can be based.

G. An Economic Growth Initiative for Lebanon

The findings of the exploratory phase have been based on a thorough review of literature analyzing Lebanon's economic structure, performance and policies, interviews to elicit information and views of government leaders, business executives and business association staff, academics, private consultants and donor officials; and an assessment of Lebanon's macroeconomic and commercial policies.

During the course of the investigation, it became increasingly clear that the substantive scope of subsequent phases of this initiative should focus on efforts to stimulate productive economic activities. This conclusion is based on the following considerations:

1. Lebanon's **macroeconomic strategy** is clearly known, and the level of sophistication of the country's economic management team is high. While there is a strong need to address the growing macroeconomic imbalances, a major activity to deal with macroeconomic policy is not necessary.
2. The majority of Lebanon's **commercial policies** - those forming the environment in which private sector firms operate - are essentially sound. In fact, they are among the most "market friendly" in the region. To be sure, a number of important commercial policy impediments remain in place, and some have been identified in this report. Nevertheless, any initiative directly solely toward improving commercial policies would not be productive.
3. A key constraint to new investments in productive activities can be summarized as **lack of confidence and direction**. This can be attributed in part to factors (e.g., regional political uncertainty, growing deficits and indebtedness) which are beyond the control of businesses, but also to a lack of consensus on a vision for the economy and hence insufficient investment in modernization in many industries.

Based on these considerations, the economic growth initiative has been organized around the concept of "industry cluster" strategies. The conceptual framework for such strategies is presented below. The basic goals of industry cluster development approaches are as follows:

- ❑ Establish effective public/private coalitions organized around a reasonably defined, common set of challenges and opportunities.
- ❑ Identify through concrete examples key policy and institutional constraints to growth, and specify practical means to address these constraints.
- ❑ Define a consensus "vision" for industry cluster and economic growth. On the basis of that vision develop actionable strategies to stimulate the growth of viable industry clusters, which will in turn serve as key engines of overall economic growth.

Lebanese Industry Clusters Proposed

Industry cluster strategies begin with the identification and definition of industry clusters holding strong prospects. The project team based its cluster selection analysis on available statistics and research, as well as on viewpoints expressed during substantive interviews. In addition, the team employed three criteria on which to base its proposed clusters:

- ❑ The activities should offer clear promise for growth, thus leading to expanded and new investments in productive Lebanese enterprises;
- ❑ The activities should be capable of creating considerable employment opportunities, tax revenues and foreign exchange earnings for Lebanon -- key economic objectives of the nation; and
- ❑ The clusters of activities should be sufficiently broad to permit the identification of broad arrays of structural and policy reform needs.

Based on this analysis and these criteria, the project team proposed that the three industry clusters – (1) Tourism, (2) Light Industry and Agro-Industry, and (3) Regional Business Services – be used for the cluster strategy development process. Each of these clusters, as described below, offer an “export” orientation as well as direct benefits for the domestic economy.

Tourism

Lebanon was once a leading tourism destination in the region, offering an impressive array of attractions for respective market segments -- pleasant climate and natural attractions, entertainment and culture, high quality hotels and restaurants, shopping, and a rich historical heritage. Many of these attractions were destroyed or deteriorated during the war, but could be restored. Tourism is a major global growth industry, and offers considerable employment opportunities for unskilled and semi-skilled labor. Tourism can also serve as a platform for the development of other industries through backward linkages and associated international services.

Light Industry & Agro-Industry

This cluster is directed at Lebanese industry broadly defined to include light manufacturing and food processing. Lebanon has historically been a service economy, but it can be argued that its socio-economic conditions require a stronger industrial base, with its potential for employment, and a revived agricultural sector which can contribute to employment opportunities and better utilization of agricultural areas, reducing social pressures and rural-to-urban migration.

Lebanon is not likely to prove competitive in world markets for mass produced manufactures, and it is not advisable to engage in manufacturing processes which are energy intensive or polluting. As a small, touristic country in which natural beauty is a major attraction, the country can ill afford aggravating its already existing environmental problems. Lebanese

industry should seek product areas which involve flexible manufacturing and substantial value added in the form of technical input, design and quality.

Regional Business Services

This cluster consists of a potentially wide array of productive activities, including regional banking and financial services, trading, communications, media/advertising/printing, and other business services. In theory, it could also be expanded at some stage to include regional education and health services, both previously major foreign exchange earning activities in Lebanon. This cluster is intended to test the hypothesis that Lebanon can restore its role as a regional business center. These activities face the prospect of significant growth in the Middle/Near East region, and offer high value employment and income producing opportunities.

Regaining Lebanon's previous preeminence in regional entrepôt activities will not be easy. Financial services offer the greatest potential for growth. However, the banking and non-bank financial institutions will need to grow in size and improve their product offerings if they hope to support overseas business activities.

Other areas of potential service cluster growth include advertising, finance, insurance, printing and publishing. To succeed in these areas, Lebanon needs to differentiate its product from that available in world centers, whether by language, cultural affinity or in-depth knowledge of the region's requirements. Potential clients have to feel more comfortable dealing in Lebanon than in Europe, for example, and confident as well that the level of service they receive is world class. Again, the legal and regulatory framework has to be right and the technical level of service competitive with world best practices.

II. THE POWER AND PROCESS OF INDUSTRY CLUSTER STRATEGIES

The industry cluster approach to economic analysis and strategy development is a powerful framework for stimulating and sustaining accelerated economic growth. Born out of the need to evaluate economies and institutions in a manner that accounts for and sheds light on important regional strengths and weaknesses, this innovative methodology goes beyond merely assessing the comparative advantages and competitiveness of regional industries, to understanding and acting on the competitiveness of the linkages between industries and the relationships between industries and a region's economic foundations. In applied research and consulting projects, SRI and others have noted that regions with solid clusters of mutually supportive companies retain, attract, and develop companies far more successfully than regions with weak industry groupings.

- ❑ The use of clusters captures the economic relationships among specific industry sectors in a dynamic way, providing a far richer source of information about regional economic inter-relationships than is available from more traditional economic development strategies.
- ❑ The use of clusters provides a powerful set of tools for analysis, policy formulation, and regional organization to increase the effectiveness of industry development strategies.

Cluster-based development strategies are based on the identification and analysis of *economic clusters* of competing, complementary, and interdependent firms within a region that are related to each other through buyer-supplier linkages and shared *economic foundations*. SRI research has shown that horizontal and vertical networks of large and small firms in manufacturing and service industries, combined with supportive economic foundations, create competitive advantage and propel regional economic growth in the global economy.

What Is an Industry Cluster?

Every location, whether a nation, state or region has a set of unique local conditions that underpin the ability of companies based there to compete in an industry. The competitive advantage of a location does not normally arise in isolated companies but in clusters of companies. These firms are in the same or related fields or are linked by buyer-seller relationships, common customers, or other relationships. An industry cluster is a group of companies that rely on an active set of relationships among themselves for individual efficiency and competitiveness. These relationships have four prominent characteristics:

- ❑ ***Buyer-Supplier Relationships.*** This cluster element is the one most frequently described in economic development literature. It consists of core companies that produce goods and services that are sold to final consumers and of companies at earlier stages in the value-adding chain that supply the inputs -- intermediate goods and services and raw materials -- that are assembled into or used in the assembly of final goods and services. Distributors of final goods and services, where separate from the producers, may also be a part of these clusters.

- ❑ ***Competitor and Collaborator Relationships.*** This cluster characteristic, consisting of companies that produce the same or similar goods and services at a specific level in the value chain, exists because competitors frequently share information (often unintentionally) about product and process innovations and market opportunities) and may, in fact, formally collaborate to develop such innovations in pre-competitive or strategic alliances. While there is cooperation in some areas, there must be rivalry among firms in order to create regional and international competitiveness.
- ❑ ***Shared-Resource Relationships.*** These relationships exist when firms rely on the same sources of raw materials, technology, human resources, and information even though they may use these resources to produce goods and services for very different markets.
- ❑ ***Critical Mass of Competitiveness Factors.*** Clusters represent critical masses of information, skills, relationships, and infrastructure in a particular field. Having a critical mass of these competitiveness factors provides the foundation for a growing cluster.

A common assumption underpinning these relationships is the premise that such relationships benefit from geographic proximity. The premise is that such relationships will be stronger if the distances separating participants in the cluster are as short as possible. Physical movement of goods is obviously important. In an era where just-in-time inventory management and time-to-market responsiveness are standard elements of competitiveness and productivity, the shorter the distance from loading dock to loading dock or from desk to desk, the better.

Similarly, the flow of information that directs the flow of goods and services improves as distance decreases. Although information technologies have reduced the impact of physical distances, many activities, ranging from networking and product design to contract negotiations, are best accomplished by face-to-face exchanges. Even in such areas as financial services and information technology, where distance can be mitigated by advanced communications capabilities, industries tend to gravitate to and/or grow within given regions.

Economic Foundations

The key to competitive industry clusters is the existence of supportive economic foundations. Companies still rely to some extent on traditional advantages such as location near a transportation hub, ease of obtaining raw materials, and access to growing markets. These have been the key “drivers” of economic location theory and the reasons why countries and regions have grown where they have. Economic foundations consist of the complex array of resources needed to compete successfully in the global economy. They include:

- ✓ Skilled, adaptable, and entrepreneurial workers;
- ✓ Accessible technology and R&D;
- ✓ Available financial capital and credit, in appropriate forms and at reasonable terms;
- ✓ Advanced physical infrastructure;
- ✓ A “business friendly” economic policy and regulatory environment; and
- ✓ An increasingly attractive quality of life.

The critical factor in considering economic foundations is that different industries require different mixes of resources. Where one industry is dependent on energy, transportation, and access to raw materials, another is equally dependent on technicians and engineers that can be trained to adapt to new technological processes, and a third is dependent on access to advanced information management systems, services, and training programs. For this reason, the cluster approach not only identifies industries for emphasis, but determines the specific requirements of each target industry for specific economic foundation support.

The Need for Stakeholder Participation and Buy-in to Achieve the Results

Success ultimately depends on the commitment of stakeholders to translate the vision and strategy creation into *actions and results*. Thus, stakeholder involvement and buy-in are key to successful implementation of the strategy. The stakeholders include: private investors and operators in each cluster industry and their suppliers, government regulators, universities and other academic/training institutions and the broader community, including its residents. For this reason, clustering strategies seek to accomplish stakeholder buy-in by maximizing interaction and collaboration with the stakeholders from the very beginning. The process seeks to weave together actions aimed at important individual sectors as well as actions aimed at multiple sectors, much as a strong fabric is woven together.

The Cluster Development Process in Lebanon

The next sections summarize the development strategies for three industry clusters (tourism, light/agro-industry, and regional business services) developed during a series of workshops held during October-December 1998. In this pioneer exercise, Lebanese stakeholders were engaged in the application of a cluster development technique, the objective of which is to:

- ❑ Apply the cluster analysis tool and process to Lebanon's key "growth engine" sectors;
- ❑ Identify key relationships and sources of competitive advantage within the sectors; and
- ❑ Identify concrete initiatives and action steps to stimulate growth and enhance competitiveness within the cluster.

The cluster strategy-building process has brought stakeholders together to address challenges and opportunities through cooperative action. The workshop participants initially received briefings on the nature and goals of the cluster development methodology, international trends and best practices in their respective industry clusters, and current developments in Lebanon's clusters.

The first task of the workshops was to "map" the clusters – specify the types of products or services that should be included in the cluster. The stakeholders then proceeded through a process of identifying and reaching consensus on their cluster's SWOTS – strengths, weaknesses, opportunities and threats. Based on this assessment, a growth-oriented "vision" for each cluster was crafted. Next, the participants prepared a series of action initiatives aimed at

stimulating cluster growth. Finally, these initiatives were examined critically and refined. Throughout this process, an extensive series of interviews was conducted with government and business leaders to validate the conclusions and recommendations made by the workshop participants.

The summary results of the three sets of industry cluster workshops are presented below. Those seeking greater details on the analyses and strategies are referred to the full industry cluster reports.

III. TOURISM INDUSTRY CLUSTER STRATEGY

Before the war, Lebanon was regarded as the ideal tourist destination in the Middle East. Lebanon's scenic beauty, sunny climate and historical sites attracted more than 2.4 million visitors annually. Lebanese tourism, however, suffered dramatically with the war, as hostilities virtually destroyed its tourist infrastructure and insecurity kept visitors from traveling into the country. In Beirut alone, the number of hotel rooms fell from 10,486 beds in 1975 to 4,631 by 1979. Only 469,272 visitor nights were spent in Beirut in 1979, compared to 2,307,122 nights in 1974. The contribution of tourism to GNP, which was approximately 20 percent before 1975, declined to 7.4 percent by 1977, decreasing further to near zero during the 1980s.

Lebanon now finds itself in the midst of a rapidly changing region shaped by fierce competition for tourism dollars. Neighboring states have altered their economic policies and placed more emphasis on tourism development. Countries like Egypt, Jordan, Turkey, Greece, Syria, and Cyprus are now focusing efforts on tourism development as a means for economic independence. Additionally, while the tourism infrastructure in the above nations has been upgraded to keep up with the pace of modern technology, Lebanon's infrastructure has been destroyed or become outdated.

Currently, Lebanon is undergoing a massive redevelopment plan to rehabilitate its infrastructure. The international airport is undergoing a modernization plan to upgrade its capacity to welcome 6 million travelers annually. Seaports are being upgraded to welcome large cruise ships and ocean liners. Modern networks of highway systems are being built to link various parts of the country. Communication networks, power generating facilities, and water purification systems are some of the other grand projects that are being implemented presently.

The undertaking of large projects, along with the end of the civil war, and the hope of a Middle East peace accord have temporarily rejuvenated Lebanon's hospitality and tourism industry. The country is experiencing an unprecedented reconstruction boom where foreign hospitality firms like Marriott, Holiday Inn, Intercontinental, Meridian, McDonald's, and many others are rushing to be present in the Lebanese market. This boom in economic and exchange activities, however, has not been sufficient to return tourism's contribution to GNP and government revenues to pre-1975 levels. Moreover, it is unlikely to last. At this point, pro-active strategies are needed if tourism is ever to develop into a true revenue and employment base.

Mapping the Cluster: Priority Products and Services

The key tourism activities – both present and prospective – identified by the workshop participants include business tourism, hosting visiting friends and family members, leisure, sun/beaches, shopping, gaming, historical tourism (Roman ruins, museums, war/battle scenes, etc.), cultural activities (nightlife, music, Lebanese cuisine), outdoor activities (skiing, mountain climbing, fishing, water sports, etc.), and cruise ship tourism. The supplier industries to the tourism cluster include hotels, restaurants, shops, entertainment establishments (theaters, clubs, the Casino, etc.), transport firms, and travel agencies and tour operators.

Cluster Vision: Lebanon's tourism industry will be restored as a key source of employment, income and economic growth, providing a comprehensive set of high value tourism experiences for both regional and international visitors.

Strengths, Weaknesses, Opportunities and Threats (SWOT) Analysis Findings

Key Strengths:

- ✚ Natural resources;
- ✚ Historic and natural sites;
- ✚ Other anchoring industries (banking, universities, hospitals, etc.);
- ✚ Family ties abroad;
- ✚ Attractive night/social/cultural life;
- ✚ High-end market strategy/position;
- ✚ Human resources; and
- ✚ Evolving infrastructure.

Key Weaknesses:

- Lack of government attention;
- Negative image abroad;
- Weak promotion;
- Sub-standard regulatory framework;
- Low value/cost ratio;
- Deteriorating natural environment;
- Underdeveloped secondary roads/signage/attractions; and
- Lack of recreational activities.

Key Opportunities:

- ✓ Restructuring of government priorities;
- ✓ Institutional reorganization;
- ✓ New tourism products;
- ✓ Environmental protection;
- ✓ Training programs;
- ✓ Expanded gambling; and
- ✓ Investment incentives.

Key Threats:

- ✗ Lack of government and private sector coordination;
- ✗ Political unrest; and
- ✗ Competition.

Proposed Action Initiatives

1. ***World-Class Tourism Promotion Board.*** Perhaps the most important constraint facing Lebanon's tourism cluster is its image. The efforts of the Ministry of Tourism and various ad hoc private groups do not currently meet the important promotion needs of Lebanon. The nation's tourism promotion is far behind international standards and best practices. For this reason, there is a need to reorganize public sector participation in tourism by creating an independently funded and managed Tourism Promotion Board attuned to private sector needs and international market trends. This initiative would professionalize and improve overall tourism promotion by reforming the role of the Ministry of Tourism while expanding the role of the private sector. This future Tourism Promotion Board would be independently run, giving it the ability to operate quickly and efficiently, and be given consistent and adequate funding through a dedicated funding mechanism. The Board of Directors should consist of representatives from the various sectors of the tourism cluster, the Ministry of Tourism and other important stakeholders. In effect, this proposed initiative would restore, but also modernize, the independent structure of the former High Council on Tourism. The first steps of this initiative would be to update the charter of the High Council of Tourism to match international best practices in tourism promotion to particular Lebanese needs. This consists of researching international best practices; establishing organizational aims; designing its structure; forming a board of directors; stipulating its relationship with other organizations; and adopting an adequate funding mechanism.
2. ***Improving Lebanon's Tourism Product Offering.*** One of Lebanon's greatest needs is to enhance its tourism draw by improving conditions of current assets and encouraging new product development. Better coordination and strategic thinking can significantly improve the attractiveness of Lebanon as a tourist destination without significant government investment of its limited resources. This initiative encompasses two separate steps. First, the Ministry of Tourism, in cooperation with the Ministry of Culture and local governments, would lead in minimal infrastructure investments to improve the condition of tourism sites by cleaning their adjacent areas, improving "interpretation" through plaques and brochures, and building safety fences where appropriate. A second main thrust will consist of establishing a coordinating mechanism between the Ministry of Tourism and government investment attraction institutions to prepare new Build-Operate-Transfer proposals for maintaining and upgrading historical facilities, as well as to encourage private investors (i.e., Club Med, etc.) to develop new attractions.
3. ***Tourism Workforce Preparedness Partnership.*** As tourism continues to increase in volume and labor force needs grow, a human resource crisis is approaching, endangering Lebanon's ability to provide quality service and affecting its delicate price structure. A new Tourism Workforce Preparedness Partnership will seek to coordinate the needs of the hotel and restaurant industries with program offerings at the country's various universities and technical schools by institutionalizing a channel for private sector/academic/government communication. This advisory committee will seek to develop new internship programs and explore ways for encouraging on-the-job training.

Among the first steps to be taken will be conducting a formal workforce needs assessment review.

4. ***Strategic Data and Research.*** This initiative consists of instituting a strategic data and research center for the maintenance of comprehensive tourism sector statistics, market analysis and competitive information to support the competitiveness of Lebanon's tourism industry. The proposed center will seek to bring Lebanon out of its long period of isolation from international tourism trends. Government data gathering and research would be consolidated in this center, which would be operated in cooperation with one or more local universities. Data tasks will include compiling and updating an inventory of Lebanon's tourism assets (including tourist attractions, number of available hotels and summer apartments, and occupancy rates), as well as tracking visitor information (including numbers of visitors, origins, spending patterns, modes of transportation, and income levels). This data will be used for planning, investment decisions and other relevant private/public sector needs. Research assignments will seek to alert Lebanon's tourism cluster of ongoing international market trends, evolving customer needs, prospective niche markets, and adequate competitive "positioning."
5. ***Protecting Lebanon's Tourism Product.*** This initiative will seek to update and upgrade Lebanon's tourism regulatory framework. The Ministry of Tourism will continue to take the leading role in regulating Lebanon's tourism product, particularly through the development of a world-class hotel and restaurant rating system and other regulations to govern tourism activities properly. The private sector will work with the Ministry on an advisory basis, raising issues of concern, reacting to and commenting on proposed regulations through an institutionalized system under the Ministry. The aim will be to guard and improve Lebanon's tourism product by meeting and exceeding international standards of quality and value. The first step will consist of developing and implementing a hotel and restaurant ranking system according to international norms and standards.

IV. LIGHT INDUSTRY/AGRO-INDUSTRY CLUSTER STRATEGY

This cluster is directed at Lebanese industry broadly defined to include light manufacturing and food processing. The manufacturing sector is Lebanon's a major contributor to the national economy. It accounts for about 17 percent of Gross Domestic Product, employs over 150,000 people, and generates about 80 percent of Lebanon's exports.

The Lebanese manufacturing sector has already survived the major economic and political challenges of the war years, and now is faced with new challenges, including: modernizing its plant and equipment in order to stay competitive in world markets; updating management systems and practices; and dealing with human resource issues such as work force development and the relatively high cost of Lebanese labor.

Lebanese industrial exports are varied, indicating an ability to identify specific niches in overseas markets. Historically, the three most important industries have been paper, clothing, food products and consumer-oriented chemical products. Lebanon needs to build on its apparent comparative advantages by aggressively seeking new export markets and at the same time bracing for the very likely decline of protection in line with WTO standards, leading to intense competition for those domestic industries not able to match global standards for price and quality.

Lebanon is not likely to prove competitive in world markets for mass produced manufactures, and it is not advisable to engage in manufacturing processes which are energy intensive or polluting. Lebanese industry should seek product areas which involve flexible manufacturing and substantial value added in the form of technical input, design and quality. Selling these features successfully even in regional markets will place heavy emphasis on marketing skills.

Mapping the Cluster: Priority Products and Services

In the area of light industry, priority products are divided into two categories: Finished products, and inputs and raw materials. High potential finished products include chemicals and derivatives (including cosmetics, soaps and detergents), clothing, textiles, and furs, electrical instruments and equipment, furniture, medical/optical equipment, watches, transportation equipment, paper and derivatives, rubber and plastic materials, and shoes and leather. Growth-oriented inputs and raw materials products include packaging (cartons), labels, processing and packaging equipment, chemicals, plastics, wood, fasteners, valves and pumps, electrical connectors, sheet metal, lubricants, paints, specialty processing (e.g., heat treating), storage and warehousing, wholesale and retail distribution, and waste treatment equipment.

A wide range of high potential products were identified in the area of agro-industry. Finished products include Lebanese specialty food products (e.g., Mezza), jams, honey, olive oil, juices, dairy products, bottled water, grains and cereals, wine and arak, soft drinks, snack foods (e.g., nuts), fruits and vegetables (fresh, frozen and canned), fresh fish, confections, spices, tobacco products, vegetable oils, and ornamental flowers. Agro-industry inputs and raw materials include packaging, canning, bottling, labels, agricultural inputs (fertilizers, pesticides,

herbicides, etc.), irrigation equipment, processing chemicals and stabilizers, processing equipment, animal feeds, storage and refrigeration, wholesale and retail distribution, food services, by-products and waste treatment.

Cluster Vision: “Made in Lebanon” is an international standard of quality based on strong cooperation among stakeholders (industry, government, research institutes, non-governmental organizations, and universities) focusing on specialty light industry and agro-industry products with high margins for regional and global markets provided by consolidated Lebanese producers respecting the culture, family values and quality of life throughout Lebanon.

Strengths, Weaknesses, Opportunities and Threats (SWOT) Analysis Findings

Key Strengths:

- ✚ Location;
- ✚ Free market economy;
- ✚ Diverse climate; and
- ✚ Multi-lingual, entrepreneurial, and skilled work force.

Key Weaknesses:

- High cost of borrowing, therefore limited investment in this sector;
- Lack of market information;
- Weak export infrastructure;
- Lack of basic norms, regulations, and product standards; and
- Limited variety of export crops and agricultural products for processing.

Key Opportunities:

- ✓ Improve market information;
- ✓ Target niche markets where Lebanon enjoys a competitive advantage;
- ✓ Introduce basic health and certification standards for Lebanese products;
- ✓ Institute environmental norms and standards; and
- ✓ Upgrade product quality.

Key Threats:

- ✗ Inertia/lack of action;
- ✗ Environmental and health threats if clear regulations are not developed and enforced; and
- ✗ Competitive threats if Lebanese producers do not enhance the quality of their products.

Proposed Action Initiatives:

1. ***High Value Added Agro-Industrial Export Initiative.*** This project will help develop high quality fruits, vegetables, and processed food production and exports. The initiative will help phase out and replace lower-value commodity products currently produced in Lebanon that face stiff competition in world markets. Under this initiative, high value-added fruits and vegetable varieties will be selected on the basis of their suitability for exporting and for food processing in Lebanon. This will be a pilot program to select and propagate new varieties of such products as artichokes, asparagus, cherrimoya, figs, and avocados, olives, and papayas. Eventually the program will help develop brand identities for unique Lebanese varieties of these products.
2. ***Prepared Food Supply for Food Service Operations.*** Currently, international food service operators from nearly all segments and menu categories are advancing into nations throughout the Middle East, including Lebanon. In addition, major retail supermarket chains are developing large “superstores” in the region. The present dependency of the international fast food chains and the supermarkets on expensive imported food items represents a major investment opportunity for Lebanese food producers and processors, if they can meet the rigorous price, quality, and delivery requirements of the major chains. This initiative will investigate current supply procedures of major food service chains and supermarkets, and evaluate and develop Lebanese supplier opportunities. The program will develop linkages between major food outlets including fast food chains and major supermarket chains and producer groups. The initiative will work towards making Lebanese companies and producer groups the preferred supplier for major chains covering the entire Middle East Region.
3. ***Demand-Driven Agro-Industrial Research.*** This initiative seeks to develop an effective research partnership among universities, government research institutes, and agro-industry companies to provide needed R&D for Lebanese producers. Under this initiative, agro-industry will articulate its research needs to universities and research on a variety of research areas such as testing, food safety, minimum processing, natural ingredients, and development of new and improved products. Research will be undertaken on a joint-venture basis on high priority market-related areas by research centers and universities. The mission of the initiative is to coordinate the research programs and ensure that they are meeting the dynamic needs of the food industry.
4. ***Food Laws Implementation.*** This initiative will work on the adaptation and modernization of existing Lebanese food laws and standards. The new law would serve to increase the safety of food, protect consumers, and increase competitiveness through food standards and regulation. In 1996 a team of Lebanese and international experts, funded by the FAO, prepared a new draft food law consistent with EU Countries regulations (CODEX). The current initiative would support a consultative discussion among the food industry, authors of the draft law, and key government regulatory ministries such as Health, Agriculture, Industry and Economy. The initiative would create a mechanism for the speedy approval and adoption of Lebanese food regulations.

5. ***Vocational Education and Training in Food Technology.*** The purpose of this initiative is to develop an up-to-date curriculum which will provide hands-on skills needed in agro-industry. The creation of a food science curriculum at one of the existing vocational schools will train food plant workers in basic plant maintenance, sanitation, food microbiology, and quality control. The project would develop a prototype plant to train students in hands-on food processing techniques for products such as ice cream, cheese, dried, frozen, and canned foods.
6. ***Total Quality Training Program.*** The global market requires products to be made to meet strict international standards. Due to its small size and relatively high cost of labor, Lebanon must compete primarily on a *quality*, and not a *cost* basis. In order to achieve this goal, the Total Quality Training Program will work to improve the quality of Lebanese products and processes through international quality training and certification (ISO 9000, ISO 14000 certification) and through comprehensive total quality training programs. Specific quality training programs would be tailor made to fit the needs of small companies and special sectors.
7. ***Industry Data for Decision-making and Growth.*** This initiative will provide reliable, up-to-date information to Lebanese industries on a regular and timely basis. Industrial investments are predicated on knowledge of characteristics of Lebanese businesses as well as identification of markets (production, consumption, demographic, and stocks statistics) for Lebanese products, services, and households. This initiative will undertake an industrial survey, and periodically update findings and make the data available through broad dissemination, through such media as the Internet, CD-ROM, and hard copy formats.
8. ***Trade Agreements Consultation.*** The purpose of this project is to provide private sector counsel on government trade policy negotiations. Under the initiative, panels of industry representatives and experts will be formed to provide expert relevant and timely input for specific bilateral and multilateral trade agreement negotiations. This initiative will ensure that industry concerns are professionally and transparently brought to the attention of trade negotiators before and during negotiations.
9. ***Business Development Centers*** The purpose of this initiative is to establish business development services for small, family-owned businesses in Lebanon. Such businesses need technical and management support to identify growth opportunities and to structure their operations for growth. The program will provide ongoing technical assistance in business development, strategic planning, export management, work force development, and strategic management.
10. ***Lebanon Product Standards.*** This project aims at developing and coordinating product standards for Lebanon. The first step in developing quality products for export is to establish domestic standards of product quality, size, and grading. With little product differentiation on the basis of certification or standards, firms are often pushed into producing at the level of the “lowest common denominator.” The initiative will establish

effective and measurable standards for major product categories in Lebanon. Initial priority will be directed at products affecting consumer health and safety.

11. ***Joint Venture Development Program.*** This project will work to stimulate joint ventures between Lebanese companies and international investors. The program will support trade and investment missions to Europe, Asia and North America. It will also fund conferences and promotional materials designed to attract foreign joint venture partners. The program will serve a match-making function between Lebanese and foreign partners.
12. ***Long-Term Investment Capital Initiative.*** This initiative will seek to develop longer-term capital mechanisms for Lebanese industrialists through the creation such mechanisms as loan-guarantee programs, venture capital funds, and long-term lending credits for industry. Currently there is an almost complete absence of any long-term loan capital for industry in Lebanon, short-term rates are high, and collateral requirements are strict. The program will identify government, private and donor sources of funding to create more financial mechanisms for longer term lending and investment in industry in Lebanon.

V. REGIONAL BUSINESS SERVICES CLUSTER STRATEGY

Prior to the onset of war, Lebanon was a flourishing regional center for financial and business services. The nation's advanced infrastructure and entrepreneurial spirit attracted both Arabs and Westerners to enjoy Lebanon's ability to support personal and professional business. The nation's liberal financial and economic policy regime, coupled with banking secrecy laws instituted in the mid-1950s, catapulted Lebanon into a safe haven for deposits by Arabs and others. This role expanded as oil-related earnings rose dramatically in the early 1970s.

Lebanon's image as the "Switzerland of the Middle East" was reinforced by its tourism assets and high quality of life. However, this image was shattered by the protracted war, during which foreigners stayed away due to concerns for personal security, and all forms of infrastructure deteriorated. In recent years Lebanon's business services industry – at least several segments of this industry – has undertaken an aggressive re-building campaign, but almost all attention has been drawn to local market issues. The regional and global economies have changed considerably. Therefore, concerted efforts will be needed in order for Lebanon to regain its position as a regional leader in financial and business services.

Mapping the Cluster: Priority Products and Services

In the area of financial services, the high potential activities include investment banking (investment in productive sectors, risk management, venture capital), insurance, human resource training, and regional headquarters support. Other areas with growth potential include private banking (mutual funds, country funds, fiduciary services), on-line financial services, regional stock exchange, leasing and factoring.

The key growth activities in the area of other business services include advertising, publishing, regional headquarters support, and human resource training. Second priority services include software (especially Arabization), telecommunications, conference center services, trade and transshipment, and medical services.

Cluster Vision:	Lebanon will become a model as the investment banking and business haven to the region, acting as a catalyst for real, productive economic investment and development.
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Strengths, Weaknesses, Opportunities and Threats (SWOT) Analysis Findings

Key Strengths:

- ✚ Open market system;
- ✚ High quality human resources;
- ✚ Diaspora resources;
- ✚ Low tax rates;
- ✚ Strong Central Bank supervision;
- ✚ Banking secrecy laws;

- ✦ Effective business establishment laws;
- ✦ Free capital flows;
- ✦ Multi-culturalism; and
- ✦ Lebanese entrepreneurship.

Key Weaknesses:

- Negative international image;
- Lack of enforcement of regulations;
- Legal gaps and inefficient judicial process;
- Bureaucratic inefficiency;
- Lack of data;
- Lack of transparency;
- Family ownership and management;
- Small scale operations;
- Weak internal systems; and
- Lack of confidence.

Key Opportunities:

- ✓ Reposition Lebanon as a regional center;
- ✓ Tap Diaspora resources;
- ✓ Develop strategic alliances; and
- ✓ Negotiate to lower regional restrictions.

Key Threats:

- ✗ Regional political instability;
- ✗ Global financial crisis;
- ✗ Reversal of regional opening; and
- ✗ Competition from other centers.

Proposed Action Initiatives

1. ***Establish a Business Service Task Force***, a private sector body to oversee cluster development initiatives and conduct policy reform advocacy activities. The Task Force will function as a “board of directors,” providing effective coordination among relevant business associations to carry out initiatives, and provide a coherent private sector voice for promoting the growth of financial and other business services. It will be based in part on the concept of the “Invisibles Group” of the City of London.
2. ***Modern Management Training***, an initiative to assist Lebanese financial and business service firms to install effective management structures and processes. This initiative will provide specialists in contemporary management training techniques to conduct short-term courses for middle-level and senior managers of financial and related services companies in Lebanon. The goal of the courses will be to introduce modern management

concepts to Lebanese firms to enable them to improve their efficiency and economies of scale, both of which are requisites to international competitiveness.

3. ***Lebanese International Business Network***, an effort to expand and utilize a database of overseas Lebanese to nurture business links. The goal of this initiative is to develop international links between Lebanese private sector firms and Lebanese expatriate nationals abroad to introduce Lebanese firms to international financial/business opportunities (specific transactions, strategic alliances, joint ventures, etc.). This initiative will build upon the Transfer of Knowledge Through Expatriate Nationals (TOKTEN) program sponsored by UNDP and CDR, and will concentrate on developing a more formal Lebanese international network via the Internet for the purpose of business matchmaking.
4. ***Lebanon “Back in Business” Public Relations Campaign*** to restore a positive image of Lebanon and confidence within Lebanon. This initiative will involve organizing and conducting an international public relations campaign indicating that Lebanon is “back in business” in order to restore a strong positive image of Lebanon in general, and specifically focused at building international awareness and confidence in Lebanon as a regional business services center. The campaign should be carried out in close collaboration with the Ministry of Tourism as well as government development agencies.
5. ***Corporate Structure Enhancement***, to identify appropriate means to encourage corporate consolidations, mergers, public ownership through stock listings, and joint ventures. Most Lebanese firms do not enjoy the size of operations required for international business ventures. This initiative will focus attention on the need for industry consolidation, and to identify possible incentives (tax, technical assistance, information, etc.) to support public ownership, joint ventures and other methods to increase the scale of Lebanese firms.
6. ***Middle East Training Institute***, to provide financial/business and other forms of training to foreign students from the region. Lebanon served as the key regional training center for liberal arts, language, business, medicine and other areas. This initiative is aimed at restoring that role by developing a training institute for financial and business services. The institute will build upon existing programs in Lebanese universities. Courses will focus on technical and management issues related to financial and business services, and will be oriented toward serving students from regional countries.
7. ***Information Technology Working Group***, to identify needs and actions to install advanced information technologies in business services firms. This initiative will identify and implement appropriate steps to assist financial and other business services firms to introduce advanced technologies in order to enhance their competitiveness and increase the range of services they provide. The first step for the working group will be to conduct a thorough technology needs assessment. Following this diagnosis, the working group will specify actions such as training, policy reform, or information dissemination required.

8. ***Lebanese Parliamentary Research Center***, to provide policy research and analysis on relevant legislative issues. The goal of this initiative is to develop within the Parliament a capability to generate its own, independent research and analysis of emerging economic and business issues. The Center will allow legislators to become better informed about the implications of legislation affecting the private sector, especially as many policy reforms and new laws are being considered. An informal working group of representatives of leading business associations and economic research centers will examine current capabilities and efforts such as the program supported by Canadian (CIDA) funding, and develop recommendations for longer-term activities.
9. ***Exploration of a Capital Markets Authority***, assessing the merits for establishing an authority to stimulate capital markets growth in Lebanon. The cluster participants concluded that a capital markets authority is needed to provide the legislative, regulatory and oversight needed to strengthen Lebanon's capital markets, develop new instruments, and prepare firms for international business activities.

APPENDIX A

INDUSTRY CLUSTER WORKSHOP PARTICIPANTS

Tourism Industry Cluster

	<u>Name</u>	<u>Affiliation</u>
<i>Lebanon Stakeholders</i>	Mr. Sati Arnaout	Independent
	Mr. Joseph Coubat	Le Vendôme Intercontinental
	Mr. Yafet Edde	Edde Travel
	Mr. Elias Feghali	EMF Group
	Mr. Negib Fikani	Hard Rock Café, ME
	Mr. Louis Hobeika	Int. Chamber of Commerce
	Mr. Jamil Iskandar	DRHTC sal
	Ms. Leila Khattar	Ministry of Tourism
	Ms. Marie Kortbawi	Lancaster Hotel
	Mr. Joseph Moudabber	Century Park Hotel
	Mr. Fadi Saab	TMA
	Mr. Malek Tabbara	Olympic Airways
<i>Project Team</i>	Mr. Albert Andraos	LAU – Business School
	Ms. Carla Feghali	LAU – CSR
	Mr. William Fothergill	SRI Consultant
	Dr. Saiid Ladki	LAU – Business School
	Dr. Georges Nicolas	LAU – CSR
	Mr. Santiago Sedaca	SRI

INDUSTRY CLUSTER WORKSHOP PARTICIPANTS

Light Industry/Agro-Industry Cluster

	<u>Name</u>	<u>Affiliation</u>
<i>Lebanon Stakeholders</i>	Mr. Chafic Abi Saiid	Electricité Du Liban
	Mr. Marc Abi Zeid	Cons.Steel & Leb. Steel Ind.
	Ms. Thana Abu-Ghida	Industry Research Institute
	Mr. Marco Ayoub	Ayoub Industries & Com. sal
	Mr. Bassil Bahous	Sleep Comfort Liban
	Mr. Mounir Bissat	Bissat Factories
	Mr. Fady Frem	INDEVCO
	Mr. Serge Hochar	Chateau Musar
	Mr. Atef Idriss	Conserves Modernes Chtaura
	Ms. Nadia Khoury	Industry Research Institute
	Ms. Amal Rez	Industry Research Institute
	Fadi Saab	TMA
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	Mr. Salim Zeeni	Zeeni's Trading Agency
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	Dr. Jack Bishop	SRI Consultant
	Mr. Peter Boone	SRI
	Ms. Carla Feghali	LAU – CSR
	Dr. Georges Nicolas	LAU – CSR
	Dr. Mars Semaan	LAU – Business School
	Dr. Laszlo Somogyi	SRI Consultant

INDUSTRY CLUSTER WORKSHOP PARTICIPANTS

Regional Business Services Cluster

	<u>Name</u>	<u>Affiliation</u>
<i>Lebanon Stakeholders</i>	Mr. Elias Ashkar	Assn. Of Banks in Lebanon
	Mr. Semaan Bassil	Byblos Bank
	Mr. Jawad Boulos	Bankers Insurance
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